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City Council

City of National City
 National City, California

In planning and performing our audit of the financial statements of the City of National City (City) as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. The matters described below as items 08-01, 08-02, 08-03, 08-04, 08-05 and 08-6 conform to this definition.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weakness. However, of the significant deficiencies described above, we consider item 08-01 that has been described below to be a material weakness.

Statement on Auditing Standards (SAS) No. 112 requires that all matters identified by the audit process be reported to the governing board, even those that are not practical for correction (except for those matters that are clearly inconsequential). Our recommendations resulting from our audit process are as follows:

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(08-01) Inadequate Internal Controls over Cash and Investments

During our review of internal controls over cash and investments, we noted that the cash and investment portfolios for the Community Development Commission (CDC) (including cash and investments held by their respective fiscal agent) had not been reconciled to the general ledger on a monthly basis. Sound internal controls dictate that the individual in charge of reconciling the cash and investment portfolio to the general ledger ensure that all cash and investment activities (i.e., purchases, sales, transfers, interest earnings) have been accurately and timely recorded in the general ledger. This procedure should be done soon after month end in order to efficiently detect and resolve any discrepancies or unauthorized transactions that might occur.

Recommendation

We recommend that the CDC reconcile and record all cash and investment activity to the general ledger on a regular monthly basis. We further recommend that the City and CDC consider the use of a third party custodian in performing investment transactions for all investments held. The involvement of a third party custodian (separate and distinct from the institution that executes the investment purchase on the City and CDC's behalf) enhances the internal controls over investments by decreasing the risk of fraud by the counter party, the party that makes the investment purchase.

(08-02) Inadequate Records on Housing Project Capital Assets

The Morgan and Kimball Towers' housing projects of the Community Development Commission of the City of National City have not maintained adequate detailed records relating to their capital assets. It was further noted that Morgan and Kimball Towers did not have a routine physical inventory count on its capital assets and there was no information provided by management to identify the amount of capital assets that have been replaced or disposed of during the fiscal year. The Morgan and Kimball Towers should maintain detailed records that reconcile to the total ending capital assets and related accumulated depreciation recorded in the general ledger in order to ensure such assets exist and that depreciation is correctly calculated.

Recommendation

We recommend that management review purchases during the year and properly capitalize additions. In addition, a physical inventory should take place at least once every two years to ensure that capital assets that have been replaced or are no longer in service and have been properly removed from the accounting records. The inventory listing should be reconciled to the total ending capital assets and related accumulated depreciation recorded in the general ledger.

(08-03) Controls over Misstatements Reflected in the Financial Statements

An important element of internal control is that management's review of the financial statements be highly effective to detect misstatements reflected in the year end financial statements. While this review currently contributes to the objectives of the financial reporting process, this review does not rise to the level necessary to detect misstatements associated with some of the more complex and technical elements reflected in the financial statements.

Currently, the audit firm is relied upon to prevent or detect misstatements in the year end financial statements. Auditing standards require that client systems be effective without reliance upon the audit process. This is because a key role of the auditor is to evaluate the effectiveness of the client's financial reporting control systems. The audit firm cannot be a part of the client's internal control system that is evaluated during the audit process.

Paragraph 19 of the Statement on Auditing Standards No. 112 requires that the auditor include in the report of significant control deficiencies any material adjustments detected by the audit process. For the year ended June 30, 2008, material adjustments detected by the audit process were as follows:

- Entry to adjust the balance of loans receivable and to correct the fund from being out of balance.
- Adjustments to agree opening fund balances to prior year audited financial statements.
- Entry to restore cash and to record a liability that related to an expense that was paid after year-end that related to the current fiscal period.
- Adjustment to eliminate revenues and expenses that related to the movement of funds from one fund to another.
- Entry to adjust the estimate for claims to the actuarial determined amount.

Recommendation

We recommend that management record material adjustments on an annual basis prior to the start of the audit.

(08-04) Deficit Fund Balances

During our audit we noted that the following funds had fund deficits at June 30, 2008:

Nutrition Program Special Revenue Fund	\$(1,383,732)
Library Construction Capital Project Fund	(992,217)

Recommendation

We recommend that if the funds are not expected to have sufficient future revenues to eliminate the deficit, the City should subsidize these funds from other non-restricted revenue sources.

(08-05) Construction in Progress

\$1,722,955 had been expended during the year on various capital projects that were in progress at year end. These capital expenditures met the capitalization thresholds for capitalization. However, these expenditures were not accounted for as current year capital asset additions.

Recommendation

GASB Statement No. 34 requires that construction in progress be capitalized and included with capital assets in the statement of net assets. Construction in progress should be reported with other assets not being depreciated, such as land and rights of way.

Finance staff should inquire with the Engineering Department every year about capital expenditures in progress at year end to ensure that expenditures that meet the capitalization thresholds are capitalized during the year that those expenditures are incurred.

(08-06) Controls over Preparation of the Schedule of Expenditures of Federal Awards

The City prepared a Schedule of Expenditures of Federal Awards (SEFA) for the fiscal year ended June 30, 2008. It was noted that the SEFA contained the following errors:

- \$874,316 in federal financial assistance had been reportedly expended for Special Programs for the Aging Title III. However, only \$288,539 was actually received in the form of federal financial assistance. The remaining portion was primarily funded with unrestricted funds from the City's General Fund, which should have been excluded from the SEFA.
- The CRI - Mass Prophylaxis Program had been reported on the SEFA. However, it was discovered that this grant was not federal funded and therefore should not have been included on the SEFA.
- During the County's review of the Single Audit Report for the fiscal year ended June 30, 2006, it was noted that federal funds received and expended during fiscal year 05/06 through County Contract No. 45813 were inaccurately reported on the Schedule of Expenditures of Federal Awards as \$347,713 instead of \$330,567.

Recommendation

We recommend that City staff be provided with training on how to properly identify in its accounting records federal awards received and expended in order to ensure that the amounts reported on the Schedule of Expenditures of Federal Awards are accurate.

During our audit, we became aware of an instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133. Our recommendation regarding this instance of noncompliance is as follows:

(08-07) Subrecipient Monitoring

The City distributed \$256,906 to various program subrecipients during the fiscal year. It was noted that the City completed a risk assessment of the contracted agencies and is in the process of coordinating onsite monitoring with an outside consultant. However, actual onsite subrecipient monitoring did not take place during the fiscal year.

Recommendation

We recommend that the City perform subrecipient monitoring to ensure that its subrecipients use federal funds in compliance with applicable laws and regulations and provisions of contracts or grants.

During our audit, we became aware of certain other matters involving the internal control structure and its operation that represents opportunities for strengthening internal controls and operating efficiency. We offer the following recommendations for consideration by the City:

(08-08) Maintenance of Section 8 Housing Tenant Files

In accordance with the OMB Compliance Supplement ("Supplement"), we selected a sample of tenant files and performed certain tests of compliance with the requirements identified in that Supplement. Our review of tenant files disclosed minor administrative errors. Per the Supplement, the City is required to inspect each unit at least once annually and document the completed inspection with a report in the tenant's file. If a unit fails an inspection a re-inspection must be performed within 30 calendar days to ensure that the deficiencies were remedied. However, we noted the following:

- We noted one file where a unit failed an inspection and 64 calendar days elapsed between the failed inspection and the re-inspection.
- We noted one file where a unit failed an inspection, which was later re-inspected and the deficiencies were corrected. However, evidence of the re-inspection was not documented in the tenant file.

Recommendation

We recommend that the City ensure that if a unit fails an inspection that a re-inspection is performed within 30 calendar days to ensure that the deficiencies were remedied and that evidence of that re-inspection be maintained in the tenant file.

(08-09) Consolidation of Funds in the Accounting System

Currently, the City has over one hundred funds in their accounting system. Although some funds are required to be reported separately, the majority of the City funds may be combined into the same fund if they are similar in nature (i.e. certain grants). Different revenue and expenditure accounts may be used to segregate those funds that are combined into one in order to continue to account for them separately.

Recommendation

We recommend that the City consider combining certain funds in their accounting system for ease of accounting and reporting.

This report is intended solely for the information and use of the City Council and management of the City of National City and is not intended to be and should not be used by anyone other than these specified parties.

Mayer Hoffman McCann P.C.

Irvine, California
March 31, 2009